

Submission

by

DENISON MINES LIMITED

on the

PROPOSALS for TAX REFORM

to

THE HOUSE OF COMMONS STANDING COMMITTEE
ON FINANCE, TRADE AND ECONOMIC AFFAIRS

AND

THE STANDING SENATE COMMITTEE
ON BANKING, TRADE AND COMMERCE

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INTRODUCTION

Table of Contents

CHAPTER	PAGE
Introduction.....	1
1. Economic Environment and Tax Reform Perspectives.....	3
2. Appraisal of the White Paper Approach.....	7
3. Capital Gains.....	21
4. Corporations and Their Shareholders.....	29
5. International Aspects.....	36
6. Mineral Industries.....	40
7. Conclusion.....	44

INTRODUCTION

Denison Mines Limited, is a relatively young company which has nonetheless played a significant role in the development of Elliot Lake, a previously undeveloped part of Canada, and of the largest uranium mine in the world. This mine has served as the wellspring for diversification of the Company into oil production in Alberta and cement production and building materials in Ontario. Mineral exploration activities are currently being carried on in six of Canada's provinces, one of its territories and five foreign countries. Sales of uranium and cement are conducted on an international basis. In addition, the Company has major investment positions in a wide variety of fields, both in Canada and abroad.

For us, Canada has been a land of opportunity—where initiative and risk have been rewarded—where success for the Canadian economy has been shared with those who helped make the success—and where one success can be used to build another—for both the builder and the people of Canada.

We think this linking of performance with reward is still important—perhaps more important than ever in a world where many young and not so young people question the very worth of performance. We think entrusting scarce resources to those who have proven an ability to make good use of them also remains important. And we think that building up for the future, for ourselves and for coming generations, is still a powerful human motivation that should not be carelessly discouraged or frustrated.

Our approach to the White Paper is primarily based on this experience and this philosophy. For this reason, our brief will present this philosophy and suggestions based upon it. This philosophy has been at the heart of the Canadian economy and a central reason why it has done well for Canadians. We think Canadians know this and that they will reject tax reform that fails to take it into account.

This brief concentrates on the development of an appropriate tax philosophy for Canada in the seventies, rather than on the details of

particular proposals of the White Paper. This philosophy differs in a number of important respects from the apparent approach of the White Paper. Philosophy is in our opinion the key question raised by the Proposals for Tax Reform. Support for or opposition to particular changes is not as important as the reasons for such support or opposition. We have made a determined effort to articulate and develop carefully our reasons for support or opposition.

Our approach attempts to reflect a long view. Our concern is for the ecology of our kind of economic environment. Our test is whether changes will strengthen or weaken the essential health of our economic environment which is the foundation of all equity, just as our natural environment is the foundation of all life.

We commend the most serious study of the implications for our economic environment of any tax measures which would favour consumption over savings and which would shift the balance even more away from individuals and private groups toward the state. These are the two central issues raised by any tax reform in Canada for the seventies.

1 Economic Environment and Tax Reform Perspectives

1.1 Canada inherited a matchless natural environment. Unwittingly, and, regrettably, also wittingly, we have begun to threaten it seriously. We have slowly learned about the ecology of our natural environment—for example, of how products which have passed every other test still fail the ecology test—because cumulatively through time they damage the very environment itself. We now know that we can irreversibly pollute a Great Lake—or even the Arctic. But this has been largely hindsight. Unfortunately, foresight cannot be proven in advance.

1.2 We are already seeing how a little bit of inflation that no one worried much about can pollute the economic environment. All the weapons in the modern economic arsenal are not finding inflation easy to fight at acceptable cost. This fight against inflation has become a very messy business which is dangerous to our society and economy. A thoughtful and careful approach is essential when the main cost of economic mismanagement is paid by the poor and unemployed.

1.3 The natural response to the difficulties of running more and more of the economy from Ottawa would be to turn more resources back to the people. Now is the time to let those close to the action make more of the decisions, take more of the risks and accept more of the consequences—when those far from the action aren't doing too well. Regrettably it is not generally in the nature of bureaucracies to reduce their claims on resources. Their view seems to be that if only they had more rather than less, they could do the job. Yet the broad negative reaction towards increased taxes which we have been witnessing should be a warning signal to those who still drink deeply of the conventional wisdom that government expenditures must forever lay claim to increasing portions of the national income.

1.4 We recognize that there is a need for public expenditure on many programs including new programs. But needed expenditures should be

financed primarily by pay-as-you-go taxation of income and consumption, if the real benefits of a dynamic economy are to be realized. We are now re-learning the old lesson that he who would build a house must first sit down and count the cost, to see whether he can afford it. Having failed to do this in the sixties, we are now paying the price in inflation, unemployment, record high taxes and reduced economic growth. Everyone knows how unfairly this price is distributed among Canadians.

1.5 Canadians are far from convinced they are getting full value for their tax dollar. Much of the present government revenue requirements and related inflationary pressures are due to new government expenditure programs, for which no sound forward estimates were given. No matter what tax system is adopted, until government expenditures are based on sound planning and full disclosure, no one should be expected to feel his taxes are fair.

1.6 Thus radical tax reform before expenditure reform is to put the cart before the horse. This approach lacks the simple qualities of credibility and good sense. Who else would knowingly dare such an approach except those who have become accustomed to thinking of themselves as the sole custodians of what is good for Canada.

1.7 No one man or group of men can make an exclusive claim to advancing the well-being of Canada. The responsibility rests on all and the only test is results. Canada has been built on the foundations of individual effort and initiative. Acceptance of the view that governments are inherently better spenders or investors of the earnings or savings of the private sector can only be destructive of these foundations. Blank cheques must not be given in advance. Each of the claims of government for more money must be proven one by one. No other approach will be acceptable to Canadians whose individual ambitions are increasingly thwarted by high prices, high interest rates and heavier taxation.

1.8 What Canada needs is the prescription of some reality therapy for its affairs—a recognition of the hard but simple truth that a good

life on this planet has always needed and still needs a good effort, and that the full effort needed won't be forthcoming if the fruits of that effort are unfairly dealt with.

1.9 A tax system does not exist in isolation as a thing in itself. It is of central importance to the condition of the economic environment. In a word, we must not only guard the natural environment for ourselves and future generations, we must guard the economic environment as well. Not everything is right in Canada—but we would do well to ask ourselves whether we would prefer any other significantly different economic environment to the one we have. For on the whole it has served Canadians extremely well by world standards. There is every expectation it can do even better in the seventies, if we grasp the opportunities.

1.10 Tax changes as such are one thing. But tax changes which would radically alter the economic environment are something else again. The first charge on Canadian economic policy is to preserve and strengthen the economic environment—so this must also be the first test of tax reform. The onus is on those who propose radical change to establish that it will preserve and strengthen the economic environment.

1.11 It is easy to be glib about likely effects in a single year—and suggest minor adjustments may be easily made by the flip of an economic dial. But the balance of the economy, like the balance of nature, cannot safely be ignored. Imbalances can be very difficult to set right, as we are witnessing in the present fight against inflation.

1.12 Canadians can now see that inflation control and economic growth through improved productivity are the essential foundations of any economy that hopes to be fair. It doesn't really matter how beautiful Nero's music may be, if Rome still burns. The same goes for tax changes bought in the name of equity at the expense of the economic foundations of all equity. What poor or inflation-ridden society can we point to that is also fair? It is not an acceptable road to greater tax equity to accept a reduced performance from the economy. There could be no more cruel deception than this whether

by error or design—and as is always the case, it will be the hopes of the expectant disadvantaged that will be most dashed. We do not say that economic efficiency and equity are one—only that you get the most of each when they are effectively linked together. Unfair societies are not as efficient as they can be and inefficient societies are not as fair as they can be. The inefficiencies of inflation and unbalanced economic growth have produced far more unfairness in a year than the worst defects of the present tax system have in a decade.

1.13 Achievement—in small things and in great things—is a positive human trait. The most human society is the one that most encourages achievement of every kind by individuals—a society that provides the framework for independence rather than dependence. In today's world, we must work together as well as alone. But it is independent men, not dependent men, who work best together. Individual achievement is not an anachronism, as some may think, but the very oxygen of a free society.

1.14 Achievement has two conditions—a worthy challenge and the incentive to meet the challenge through initiative and effort. Canada is full of challenge. Let us also be certain it is full of incentive, so that there will always be the initiative to meet the challenge. For only an incentive society can be a great society.

1.15 The size and complexity of our society is often used as an excuse for more and more central control. But this is defeatism. Canada still has a chance to learn from others and avoid the dehumanizing effects of living in a society where individual effort is felt to count for less and less. Centralized bureaucracies are surely not the path of the future—or the approach Canada would like to take. Decentralization—leaving resources in the hands of the people who earned them and of governments closer to the people than the central government—must be the key to any tax reform that aims to strengthen rather than weaken the individual, especially the individual who will respond to the incentive of opportunity.

1.16 These then are the perspectives for tax reform, if it is to serve Canada in the coming decade.

2 Appraisal of the White Paper Approach

2.1 How well does the White Paper reflect the imperative of preserving and strengthening the economic environment which is the only basis for improving both fairness and the quality of life? Not very well at all. Unfortunately, three of the major requirements—savings, inflation control and the growth of international trade and investment—and their relationship to economic growth and social needs—receive minimal consideration.

2.2 We have discerned six main elements in the White Paper approach to tax reform:

- the social objectives;
- the equity aspects;
- the structural aspects arising out of the decision that the social and equity objectives could only be met by a radically different tax structure;
- the virtual absence of any assessment of the proposals in the light of major national objectives for the seventies—the stress on only the income tax part of the total tax system;
- the sheer size and scope of the proposals in relation to the digestive capabilities of the legislators, the tax administration, the taxpayers and their advisers; and
- the clear thrust of the White Paper to increase taxes on a basis which ensures that a steadily increasing share of the national income will go to the federal government.

Social Objectives

2.3 A major social objective of the White Paper is to relieve the level of taxation on lower income Canadians through higher exemptions. This can be achieved within the framework of the present system. Indeed, having regard to inflation, some revision is at least ten years or more overdue.

2.4 Similarly, recognition that employees and working mothers incur expenses to earn income is long overdue. The employee deduction proposals will provoke no dispute among Canadians, unless to assert that the proposed provisions are not as fair as they might be relative to the tax treatment of expenses of other taxpayers.

2.5 Generally, the proposed inclusion of current income items not presently included in taxable income is fairer and thus productive of social benefit. However, a serious departure from the usual principle of including in income amounts flowing from previously deductible expenses is noted in the case of strike pay which comes out of tax deductible union dues.

2.6 There is also the question of tax avoidance. Here, the only question is as to means, not ends, once a scheme of tax avoidance that is improper has been identified. A problem may arise as to what is indeed improper avoidance. For example, under the White Paper closely-held share gains are to be taxed in full while only half of widely-held share gains are to be taxed. The White Paper appears to contemplate only half-tax treatment for closely-held shares sold in the process of becoming widely-held shares. Thus, today, it may not seem tax avoidance to “go public” and so cut the capital gains in half. But perhaps tomorrow it will, especially if special “go public” vehicles are created for this very purpose, so that the full tax is seldom if ever collected on closely-held shares. We may find stamp collections and paintings going public to get the lower rate. And why not? If a business or land can do so, why not stamp collections, when all are being treated alike at the 50% rate? And yet, will those who cannot go public feel that they are being fairly treated? Is this what we want from a tax system?

2.7 Many of the features of the present tax law complained of in the White Paper are in this category. At one time, they were regarded as proper—now they are regarded as being improper. What makes a tax legally avoided also improperly avoided? How can one tell in advance, especially if the government has not been able to do so or has not seen fit to do so? And if one can, why not say so in the law?

2.8 In too many cases, the sound “let the punishment fit the crime” approach is abandoned for the approach that if anyone has ever committed or might ever be able to commit “a crime,” everyone must be punished. This is not a sound approach. The proposed global approach to “loopholes” is neither fair nor socially constructive. All Canadians will support elimination of “genuine” loopholes. But serious questions need to be raised about the White Paper approach. Are all the alleged loopholes really loopholes? And even if they are, must they be dealt with by major structural changes with serious and uncertain side effects?

2.9 The final social objective is to subject capital gains to tax. However, the case is far from clear for a country with the fantastic potential for development which Canada has. More important is the possibly unintended effect and thrust of the White Paper not simply to tax capital gains, but to do so in a way that, along with other changes, will seriously downgrade and impair the role of private capital in Canadian hands. If capital gains are to be taxed, it is essential that the tax be structured so that the adverse effects on savings and risk taking are minimized, and so that there is a minimum impact on the efficiency of capital markets. We expand upon our views in this regard in Chapter 3.

2.10 Two separate but closely linked social objectives do not appear to be among the objectives of the White Paper. The first is the importance of strengthening the individual element in our society through incentives to achievement. The second is the importance of strengthening the pluralism of our society by seeking to broaden the direct participation of more Canadians in their own economy through savings and investment. It is essential that they be included among the social objectives of the ultimate tax reform.

Equity Aspects

2.11 There is little doubt that widening the tax base by including many previously excluded items of income and broadening deductibility of legitimate employment expenses improves the equity of the tax system. While this is important, this is regrettably the only

significant equity contribution of the proposals. Of course, the reduction of unrealistic and punitive top rates is equitable, but the balance of the rate structure changes do not improve equity for middle income taxpayers, but rather worsen it.

2.12 While a top 50% rate is sound in principle, we do not count on it being held by both federal and provincial governments. We are thus wary of the inflexibility of a system which depends on a roughly equal top corporate and personal rate. For example, a top corporate rate of 54% and a top personal rate of 56% will mean an effective 60% rate on distributed or integrated business earnings of closely-held corporations. This increase of 20% over the 50% proposed rate is not insignificant—and, constitutes a real threat to the viability and reality of the integration proposal—especially as each of these rates is only slightly higher than the 50% and is quite in line with some existing rates when the provinces are taken into account.

2.13 The equity defects of the White Paper proposals are several—and major:

- unreal inflationary gains will be taxed without alleviation, while real losses will not be fully recognized where inflation is significant;
- the proposed exemptions and rate levels will become increasingly inappropriate in real terms through the effects of inflation.
- the different integration and capital gains rate proposals for closely-held, widely-held and foreign corporations will create a host of inequities between people in essentially the same position, depending on their status and their ability to shift from a less favourable to a more favourable status. These inequities will be dramatic in many cases—and could be an incitement to tax manipulation;
- the negative effects of the White Paper proposals on economic growth and inflation control will hurt every taxpayer but especially the lower income taxpayers;

- the taxing of small corporations on the same basis as the largest corporations merely strengthens the advantage that the large always have over the small;
- the man who creates and saves may be subject to a combined 75% estate and capital gains tax, while the man who spends may be subject only to a 25% capital gains tax;
- the roll-over of capital gains taxation on death will, in practice, discriminate severely between those who leave assets that must be sold, thus attracting capital gains taxation, and those who can avoid such a sale;
- proposals which frankly set out to discriminate against non-residents may appeal to self-interested nationalism, but can hardly represent an improvement in equity. It is the essence of equity that it be capable of application to all. Where it cannot be so applied, whatever else it may be, it is not equity; and
- the proposal to deny legitimate business expenses presently deductible for the purpose of determining taxable income. It is not fair to tax income while denying deduction of the costs of earning it.

Structural proposals

2.14 None of the three requirements of good structure are present in the structural proposals of the White Paper:

- durability
- understandability
- flexibility

The integration of personal and corporate taxes, the distinctions between three forms of corporation, and the differential capital gains treatment of different shares and real assets would create such complexity, inflexibility, inequity of treatment and tax motivated decision making that the new system would be inherently unstable.

2.15 The tax stakes of different status will be so high that the system will come under severe strain almost immediately. The choices

will involve 50% tax reductions on dividends or capital gains, 50% increases in loss deductions, and from generation to generation avoidance of capital gains taxation, depending on how deals are structured. Past experience makes it quite clear that the results of this will not long be tolerated, so that the instability will quickly lead to a lack of durability as well.

2.16 The case for radical reform of the tax structure is far from proven in the White Paper. The alleged need for radical reform is largely a facile assertion that has gained some currency through frequent unthinking repetition, more by way of ritual chant than documented evidence. The hard gains for people are not documented while the disadvantages are numerous and clear. The case for radical reform does not arise so much in the real world as in the minds of theoreticians who are seeking the conceptually pure tax system as a thing in itself—a modern day version of art for art's sake. This may be suited to the groves of Academe—but not to the reality of Canada in the world of the seventies.

2.17 A stated aim of the revised tax structure is to reduce tax motivated decisions by putting capital gains and income on a comparable tax basis and achieving a common personal and corporate tax rate so that corporate and personal tax can be integrated—thus eliminating the so-called surplus problem. The authors of the White Paper proposals had to recognize that this approach will not work for the large corporations that do most of the business in this country. Despite this sound conclusion, they would still not let go of the twin ideas of capital gains as income and integration of corporate and personal income tax. They failed to recognize the distortions and instability inherent in two sets of rules and effective tax rates applied to essentially the same assets and income and they have tried to cure an admittedly unworkable approach by applying it only half way. Instead, they should have faced the fact that if treating gains as income and the corporate tax as a tax on shareholders would not work for most business in Canada this logically required abandoning once and for all as unworkable both capital gains as income and inte-

gration for all assets and corporations. The resort to the closely-held widely-held distinction and to half-gains as income and half-integration is simply an unsuccessful salvage operation.

2.18 Three further structural deficiencies are clear but are not recognized in the White Paper:

- if capital gains are to be taxed, they must be taxed on a separate basis which reflects their different character. It is one thing to say the growth of the tree is to be taxed—quite another to say it is to be taxed as though that growth were the equivalent of edible fruit, or that taxing the tree will have no effect on the quantity of fruit;
- if shareholders in Canadian companies are to be relieved of tax on dividends, this should be done directly rather than by saying the corporate tax is wholly or partly a tax on shareholders—which in a large number of cases it probably is not. It is unnecessary to weave vast unprovable theories to take such a simple step; and
- if there is any possibility that governments, federal or provincial, may want higher than 50 per cent rates for either or both of personal or corporate taxes, as there certainly seems to be, it is folly to hang an entire new tax structure by the thin uncertain thread of top 50 per cent rates, however desirable those rates may seem. It is unreasonable to expect that federal and provincial governments, over the years to come, will collectively man the ramparts and defend the 50% rates to the end. This being so, a system which depends so heavily upon this single thread should never be introduced.

2.19 People don't like to be told the "system" won't let them do what they want. It is thus unreasonable and impracticable to bind future generations by introducing a system with rigid requirements. Rather we should retain a flexible system where changes in corporate income tax can occur without requiring changes in the personal income tax, and vice versa, and where changes in the taxation of income can occur without requiring changes in the taxation of capital, and vice versa.

The integrated personal and corporate tax coupled with capital gains as income simply puts too many different things into the same basket for changes to be made easily or smoothly. Surely no one believes that we are getting an unique timeless tax system immune from the corruptions of time or the changing aspirations of men.

2.20 We might be less concerned if there was some encouraging evidence from other countries that these approaches, despite their apparent disadvantages, might actually work in practice. Unfortunately, the only evidence is negative.

2.21 Finally, there is no public demand for these structural changes. There is no widespread insistence that capital gains be taxed more heavily in Canada than in the United States. The tax technicians in the private sector do not support the need for these different classifications of companies, with radically differing tax treatment. Rather, their rejection is unanimous. Nor do these technicians regard half-integration as remotely the technical equivalent of the full integration that has been rejected for most of the business income in Canada—or as having material advantages over the simpler, more flexible and time-tested dividend tax credit. The question that arises is—who does want this new tax technology?

2.22 The answer is—whoever they are, there can't be many of them. And whatever makes them want the new technology has no discernible link with the social objectives of the reform unless, of course, the downgrading of the role of private capital in Canadian hands is regarded as an important social objective. In that case, we would predict rejection of such an approach by Canadians, once they understand that the true meaning of the new tax technology is not just technological but ideological—calling for the transfer of still more resources into the hands of the state, while leaving less in the hands of the public and/or private enterprise.

2.23 The English poet William Blake was able to see the whole of the world in a grain of sand. The authors of the White Paper seem to have had a comparable vision. But no practical engineer has ever based any plans on Blake's vision. It is equally unworkable to base

tax reform on a vision which sees capital as income and the corporate tax as a tax on shareholders, while remaining unable to see all corporations as corporations, all people as people and all investments as investments.

2.24 Tax structure should be related to objectives. It is important to note that none of the social objectives of the White Paper require a radical new income tax structure, while the most important equity defects of the White Paper proposals flow from the proposed new structure.

National Objectives Test

2.25 Fair treatment in taxation is unquestionably an important national objective. So too is recognition of the actual impact of the tax system on lower income Canadians. There can be no objection that these objectives were given a high place in testing proposals for tax reform.

2.26 It is important to note that these are people tests—which is as it should be. None of the changes proposed in respect of the basic structure, capital gains, international income or the mineral industries are suitably subjected to the national objectives or people test. Rather, they are approached from the far too narrow focus of federal income taxation as a thing in itself largely divorced from economic effects and other taxes.

2.27 The tax system as a whole—and not just the income tax part of it—is a major instrument for achieving national objectives. But like any instrument, it must be designed for particular purposes if it is to help achieve them. A basic defect of the White Paper approach is its excessive emphasis on the problems of tax technology and an insufficient recognition of national objectives in people terms. It cannot be repeated too often that the only source of real and lasting improvements in the well-being of people comes from high productivity economic growth.

2.28 Thus in the White Paper the technology problems of the dual corporate rate took precedence over the people problems of small business and their importance for the renewal of the economy by a continuous stream of new entrants.

2.29 Similarly, the difficulties of distinguishing capital gains from income in some marginal cases led to a decision to ignore the real differences between them and the acceptance of the adverse economic and social consequences of taxing capital gains as income.

2.30 Further, the ambition for a radically new tax structure based on concepts not accepted anywhere else has led to proposals which would produce several potential adverse side effects. These would be seriously detrimental to savings, inflation control, international competitiveness, high productivity industry, new innovative business, regional balance and development, Canadian ownership and the Canadian stake in efficient and non-discriminatory national and international capital markets.

2.31 How could this happen in a major government document? There would appear to be two principal reasons:

- the feeling that a timeless basic tax system was the most important thing to discover and work out; and
- the feeling that fiscal and monetary policy, and perhaps government loans and grants or government corporations such as a Canada Development Corporation, can offset the damaging implications of the White Paper for growth, inflation control and regional development.

2.32 The fact is that our national objectives will not be easy to achieve and all our policies should mutually support each other. We can't afford the luxury of a tax system at cross purposes with national objectives. The very rigidity of the tax structure package—capital as income, the corporate tax as a tax on shareholders, and a common top corporate and personal rate—drastically reduces the flexibility of response that any large system needs in a period of

accelerating change like the seventies. It is ironic that at a time when established structures are more and more subject to searching criticism and substantial change, the Canadian income tax system—which is a major structure indeed—is to be virtually set in concrete, as far as future flexibility is concerned.

Size and Scope of Proposals

2.33 It is apparent we do not regard the White Paper proposals as constituting a tax meal from a master chef. But even if we did, we do not think it is possible to digest at a single meal the quantity of dishes contained in the White Paper.

2.34 Income tax is a very pervasive influence in our society and economy—and in the world economy as well. It is impossible to assess in a definitive manner the impact of radical change in such a pervasive influence. The range of initial, cumulative, and offsetting behavioural reactions of people inside and outside Canada is simply too broad to assess.

2.35 The number of skilled people able to grasp the implication of such major change, the number able to administer an infinitely more complex system and the number able to respond as taxpayers is each highly limited. There is simply no way the proposed plan is logistically feasible in an acceptable and relatively smooth way in anything remotely approaching a one or two year time-table. Insisting on more change than can be digested will almost surely mean less effective reform in the end. This would damage the credibility of government's ability to cope.

2.36 The major reforms should first achieve broad consensus—and then be introduced in an orderly fashion. To attempt more will jeopardize not only general tax reform objectives, but other equally or more important national policy objectives as well. The time for choice based on sound priorities and good payoff is here.

Share of National Income to Federal Government

2.37 The revenue implications of the White Paper suggest that little has been learned from experience. In the sixties, governments failed to reduce private demands on the economy to match increasing public

demands. Result: inflation. This happened by failing to tax to pay—in other words, a failure to match new expenditures with new tax revenues. Now, the reverse is proposed—to get in new tax revenues without any proposed new expenditures having been first presented to and passed by Parliament. In each case, the aim seems to have been to avoid having to face the public with the costs of particular expenditure programs at the time they were introduced. This “blank cheques” in advance type of approach is simply not acceptable to sensible Canadians in 1970.

2.38 Taxes have historically been the symbol of governments that have pressed the people too hard. A frank, open and responsible approach to any further increase in taxes is now an urgent priority if the viability of government itself is not to be threatened.

2.39 The White Paper fails the revenue test on seven counts:

- it involves an immediate increase in taxes on the basis of the tax take in 1969—probably in excess of one billion dollars when in full effect. This is a huge sum—and is at complete odds with the position of the federal government in requesting financial restraint. Is this an example of do as I say, not as I do? This approach strikes at the heart of the trust essential to effective government;
- no provision is made to increase exemptions and rate thresholds to reflect inflation. Not only is this unfair, especially for those below the top rates, but it would inflate the fiscal dividend already declared to itself by the federal government in the White Paper. Thus, in reality, the real tax increase in our inflationary environment will greatly exceed the one billion dollar figure. It is no answer to say the rates were set to produce a certain result in 1969, when the reform is proposed for 1971. If tax constraint were the policy of the White Paper, a little more work on figures would no doubt have been done, and rates at a much lower level projected. The fact this wasn't done suggests it wasn't intended or, at best, reveals a degree of insensitivity to the taxpayer that is unacceptable;

- the new system will not only produce more revenues of itself, together with the bonuses from inflation and real economic growth. It is also designed to produce a proportionately higher than ever before tax take out of each new growth or inflation dollar of annual income. It has been structured as a revenue producing machine beyond the fondest dreams of avarice—but all in the good name of tax reform and benefits for low income earners. The proposed revenue producing machine is undoubtedly an achievement of plutocratic dimensions. But the result is to make tax reform a benefit for government rather than for people;
- despite the apparent agreement that provincial-municipal needs are rising relative to federal needs it is federal revenues that will increase dramatically under the White Paper proposals. Before implementation of any major changes a reconciliation of the expenditure needs and tax revenues of these levels of government is essential. It is not practical to introduce major tax changes and major tax increases without agreement on these federal-provincial issues. A rigid narrow stand by the federal government on this point could have very serious implications for total tax burdens, as well as for the general acceptability of federal economic leadership;
- there is insufficient attention paid to the importance of economic growth as the only reliable generator of increased real revenues. Inappropriate taxation adverse to growth may result in a loss rather than gain in real revenues. It is a case of looking beyond the initial revenue effects to the longer run revenue effects after the tax changes work their way through the system;
- the approach to international taxation risks serious revenue losses to foreign treasuries; and
- the permitted deduction of capital losses against ordinary income could have serious effects on revenues at a time of low share and bond prices such as the present.

Summary

2.40 We are impressed with what we take to be the broad social objectives of the White Paper—but we are concerned about a serious misunderstanding of the role of capital in private hands and of individual initiative and effort in serving these objectives. However, we are satisfied that the overall equity of the tax system will be reduced rather than enhanced, and that the proposed tax structure will be more inflexible, less understandable and less durable than what we now have.

2.41 We are at a loss to understand the absence of any effective attempt to design tax provisions that would contribute to major national policy objectives, the unmanageable scope of the proposed reforms and the major tax increase implications of the new proposals.

2.42 The aim of tax reform should be to do a job for Canadians on a scale that is sensible and workable. It may be interesting to academic minds outside Canada to watch a vast tax experiment with Canadians as the guinea pigs. But being a guinea pig on a grand scale is a role that should be reserved for guinea pigs and volunteers.

3 Capital Gains

3.1 Our basic view is simple. Canada still needs the dynamic risk-taking and capital formation which the tax free treatment of capital gains has provided. Canada is young—a place of opportunity. The big win matched by the big keep of tax free capital gains is a proven spur to the risks and dedicated efforts which get new ventures started and financed—as well as an important source of savings in Canadian hands, especially for new risk ventures.

3.2 It is a form of intellectual colonialism that ill befits a pioneering vigorous country that we tamely follow the United States and the United Kingdom—both capital surplus developed countries—in imposing a capital gains tax at this stage in Canada's development. It is a form of policy bankruptcy to be espousing a policy of more Canadian enterprise for Canadians, while reducing through higher taxation of risk and capital the incentive to do the job and the savings available for the job.

3.3 Our attitude toward the taxation of capital gains is based on the view that capital and income are not the same thing; that the creation and preservation of capital can be a powerful motivation to savings, innovation and enterprise; and that capital has been and is our essential source of economic growth and thus individual well-being, especially where it is allied closely with entrepreneurial, managerial and technological skills.

3.4 Where in fact do capital gains come from? We have been able to identify only one source of real gains to the economy as a whole. The other four sources involve transfers of capital at increased values which do not represent real value increases to the economy, although they alter the ownership of real capital.

3.5 The only real source of gain to the economy is where a real capital value is created in excess of real costs. This is because the present value of the future stream of income is worth more than it cost to discover or create the source of income. In fact, the future

income from such a source will only be regarded as part of the national income when it is realized as income. But a system of taxing both capital and income will go further and tax the future income before it is realized by taxing the gain part of the present capital value of such future income—and will tax the future income again when it is actually realized. A system of taxing capital gains of this kind is nothing more than taxing income in advance of realization—a serious form of double taxation. As the income is not yet realized, it is a tax on capital. This is a very different thing from a tax on income, for what is taxed is not included in the computation of national income for the very good reason that it is not yet income.

3.6 The other four sources of capital gain are neither income nor real from the point of view of the economy, and never will be, even in the form of future income:

- inflationary gains arising from a decline in the value of money, which are illusory to both the holder and the economy;
- gains arising from a change in price-earnings ratios or interest rates—the fact that people will accept a lower rate of return than previously adds nothing directly to the total income of the economy although it results in a change from the previous monetary value of asset holdings;
- gains arising from a different assessment by the market of an asset value as a result of a revised expectation of higher future earnings—again adding nothing to the total income of the economy; and
- gains to shareholders arising from increased share prices reflecting increased retained earnings. These earnings will already have been included in national income. The increased share price reflecting retention adds nothing to the national income.

3.7 Any particular capital gain may involve one or more of these five elements. But in no case has real income yet arisen and in four cases it never will. What has been invested in real assets in the past

remains invested, however much the monetary valuation of it may have changed for any of these reasons, or however many times the equity or legal right in the real asset is transferred from one person to another.

3.8 What does all this tell us? It tells us that capital is not income—and that capital transfers are not income transactions, although services in effecting such transfers may properly give rise to current income. The very reference to “capital” markets reflects the recognition that the market allocation of capital funds is a different function from the income earning process.

3.9 If there is a case for taxing capital gains, it is a different case than for taxing income. Accordingly, different criteria must be applied in establishing the basis on which capital gains are to be taxed. The White Paper acknowledges that “a buck is a buck is a buck” is a shade on the simple side. For Canada in the seventies, with its need for more capital, enterprise, innovation and risk-taking than ever before, the criteria must be tough. If they are not tough enough, we will fall behind in international competition, economic growth and prosperity. If the name of the new game is to tax away more capital from private hands and put it in the hands of the government, let Canadians be told this. But let us not cloud this vital issue by trying to say capital gains are the same as income.

3.10 Here are the criteria:

- the base subject to tax and the rate structure must be set to recognize that many gains are not real but are illusory gains due to inflation. An inflation deflator would be ideal and must be seriously considered, along with a rate schedule separate from and lower than pay-as-you-go income rates. In any event the rates should be no higher than effective American capital gains rates and other treatment should be no harsher than American rules. All capital gains from shares and real business capital assets should be taxed on the same basis and at the same rates;
- capital should be treated as a pool in the same way as depreciable property. Transfers within the pool should be

free of tax. In this way, the efficiency of capital markets will be maintained by eliminating lock-in effects, which would be extremely serious under the White Paper;

- business inventory is valued at the lower of cost or market for income tax purposes. Any periodic revaluation proposal would thus apply a much harsher tax on capital than is now applied to inventory in computing taxable business income. It would also be an infinitely harsher test than the cash receipt test applied to almost all other income—including income from capital. A heavier tax on capital than on income must not be imposed in a decade which promises to find Canada capital short and subject to inflationary pressure. This is what results from the confusion created by trying to treat a gain on capital account as income;
- realization must be abandoned as a taxable event for capital gains. One of two things will happen if it is not. First, capital will be locked-in from generation to generation and cease to respond freely to market forces. Investment decisions will be dictated by tax consequences rather than economic merits. Second, every capital gains tax system requires some form of roll-over so as not to completely thwart economically desirable transactions. Thus the result of a realization approach is either the lock-in effect or the twisting of normal asset transfers to bring them within a defined roll-over situation. Canada is not so flush with capital that it can afford either of these inefficiencies in the operation of its capital markets;
- the proper basis is controlled roll-over for all capital realizations subject to their reinvestment. If capital gains are regarded as income, roll-overs may be considered unfair deferments of taxes otherwise due, although this would be equally true of inventory and capital cost treatment of business income. This is not so, once the different nature of a tax on capital gains is understood—namely taxing now on the basis of income yet to be earned. A capital gains tax is always the reverse of a deferment—rather it is taxing now on the basis

of an increased monetary value created by expected increased future income or a willingness to pay more for the same expected earnings;

- if capital is treated as a pool, the taxable event becomes withdrawal of capital for consumption. The penalty does not arise from making a change of investment based on economic merits, while still leaving the capital at work in the economy. Rather, the penalty is on consumption—a far more desirable approach especially for a period of capital shortage and inflationary pressure;
- under the capital pool approach there are two choices. One is the American approach of permitting a tax-free roll-over of capital gains on death together with a stepped-up basis in the hands of heirs, but continuing some form of estate taxation. The other is to eliminate estate and gift taxation and have a deemed realization on death for capital gains tax purposes; and
- the sounder approach is the latter resulting in a once-in-a-life-time taxation of capital gains retained in the capital pool. The result will be to largely eliminate tax considerations in capital transfers. In future, family capital transfers could be made on the basis of family requirements and business capital transfers could be made on the basis of economic merit.

3.11 The above approach to the taxation of capital has a number of important merits not present in the White Paper approach or in the approach of any other country. It would be a genuinely unique Canadian contribution to taxation, because it would be based on Canadian needs:

- it reflects the reality that capital and income are different, and that if capital is to be taxed, it must be on a different basis;
- it does not interfere with either business or family transfers of capital;

- risk-taking, capital creation and savings are slightly favoured and consumption slightly penalized. The present estate tax bias against saving and in favour of spending would be eliminated;
- only an individual's lifetime real gains from the economy are taxed—income annually and capital increments when spent or at death;
- taxes on these gains are paid once and only once; and
- the potentially serious damage to capital markets and government revenues of capital losses deductible from ordinary income would be avoided.

3.12 Realization as the taxable event has many economic efficiency defects. It also will be productive of significant unfairness as well. The generation to generation roll-over of all assets other than widely-held shares will help those who can avoid realization relative to those who for many different reasons may not be able to do so. Also, the effect of corporate provisions relative to amalgamation and take-over bids may compulsorily put a shareholder in a taxable realization position, regardless of his wishes in the matter. He may, for example, prefer cash to stock in a new company, yet face a tax on taking cash rather than stock. It is, of course, possible to attempt to deal with cases like these on a series of separate bases. But abandonment of realization for the capital pool approach combines maximum fairness with the most favourable economic efficiency and savings effects.

3.13 There is another way of contrasting the true economic differences between a realization and a capital pool approach. Take one taxpayer holding a \$100 share, all of it representing capital gain and another with a \$100 share, none of it representing capital gain. A new \$75 share investment becomes possible. The first taxpayer must, in effect, pay \$100 for the share, whereas the second taxpayer can get it for \$75. This is because the cost of the money needed to buy is \$25 higher to the first taxpayer—because he pays an excise (transfer) tax of \$25 to get the \$75 to pay. The anomalous situation results that the more efficient investor is always at a disadvantage relative to the less

efficient—because his cost of a new investment paid for out of sale of an existing investment will always be higher by the amount of the capital gains realization tax. It also means that for such investors, they can only afford to pay when they can find a \$75 investment which is better than their existing \$100 investment. This introduces a major inefficiency in the allocation of capital. This is avoided by the capital pool approach, where the economic cost to each taxpayer would be \$75.

3.14 It is a strange fairness that penalizes the creator and saver of the wealth employed in the economy and favours the spender of the fruits. The spender of capital gains today escapes both income and estate taxation, while the saver is hit by estate taxation. In contrast under our proposals the spender would be hit when he realized, while the saver would only be hit once on death on accrued but real capital gains. Most people will feel this is a much fairer result, as well as one more conducive to savings, inflation control, economic growth and Canadian ownership. It is inequitable to look at what a man has and to ignore why he has it.

3.15 Private capital in Canadian hands makes an important contribution to the social and economic balance of the country. But more and more economic and other activity is channeled through large bureaucracies—government, business, labour and educational. The aim of tax reform should not be to strengthen the bureaucratic element in our lives, but rather the individual element. We should be seeking new ways to encourage more savings and investment by more and more Canadians instead of being disdainful of private savings and the efforts of individuals. Unfortunately, it is not possible to point to even a single White Paper proposal which will make a material contribution to private savings and investment. It is possible to point to a great many which work in the opposite direction.

3.16 At best, it is mischievous to say that the buck represented by the tree is the same as the buck represented by the apple. At worst, it means eating the goose as though it were the same as the eggs, while continuing to expect more eggs and more geese to eat. A lot of things have changed in the 20th century, but this is not one of them.

3.17 If we do not recognize the difference, one or more of three things can happen. And Canadians must understand this before they make a choice. First, there will be fewer trees and thus fewer apples. Second, there will be fewer trees owned by Canadians. And third, the government will own more of the trees that remain under Canadian ownership. Canadians want none of these results—but will surely get them, unless there is a better understanding of the role of private capital in our society than that implied by the White Paper approach.

3.18 Facts are not always fashionable. Reassuring fiction is frequently preferred. But the fact remains that tax free capital gains have been a dynamic element in promoting Canadian growth in competition with the huge economic power of a capital surplus United States. Not a scintilla of evidence has been advanced to support a need for change now in this long-standing policy by reference to changes in the facts of Canadian life. Not a word has been said about the many benefits to Canada of a policy which has had the support of a legion of past policy makers. Have we just discovered a truth which has hitherto escaped everyone else? The White Paper capital gains as income proposal would have been more convincing if evidence and arguments had been advanced to establish why change was needed now. The issue is not resolved by recourse to unproven ideology, slogans like “a buck is a buck is a buck”, and meaningless comparisons with the United States of 1913. A major policy change with such social and economic implications merited more evidence and arguments than the capital gains proposal receives from the White Paper. Surely something better than American textbook economics of the twenties is needed to establish the wisdom of a capital gains tax for Canada in the seventies.

4 Corporations and Their Shareholders

4.1 We have seven main reasons for rejecting the proposed radical restructuring of the taxes on corporations and their shareholders:

- the reasons advanced in the White Paper that specified serious defects of the present system dictate a radical new structure do not withstand examination;
- the structure proposed rests on several errors of fact which arise in part from unrealistic economic theory developed in the United States under economic conditions very different from those existing in Canada today. The White Paper attempts modification of these theories for Canadian circumstances, but fails because the facts differ too much from those assumed in the original theories;
- there would be serious adverse effects on the important national objectives of regional development, high productivity, economic growth, inflation control, efficient Canadian capital markets, favourable access to international capital markets and more enterprise and development in Canadian hands;
- the structure as proposed will lack the essential qualities of durability, understandability, flexibility and equal treatment to make it a practically viable proposition;
- the so-called integration proposal fails to achieve a true integration of personal and corporate tax except, apparently, where the partnership option can be taken by a closely-held corporation;
- the introduction of a capital gains tax does not require radical restructuring of taxes on corporations and their shareholders as any capital gains tax must be separate from the income tax; and
- treating the corporate tax as a tax on shareholders, while not granting non-resident shareholders credit for Canadian corporate tax or resident shareholders credit for non-resident

corporate tax, opens up extremely difficult treaty-negotiating problems with the risk of substantial revenue losses to Canada.

Let us now examine a number of these reasons in more detail.

4.2 The defects of the present system as they relate to corporations and their shareholders which were complained of in the White Paper are principally four:

- income received directly by the shareholder is subject to immediate tax by him whereas the shareholder's tax is deferred on earnings retained. This begs the whole question. If the corporation and its shareholders are separate taxpayers, what deferral of tax is there? The corporation, that has earned the income, pays. The individual also pays, if and when he gets it. It is only if they are really the same taxpayer that deferral arises. The White Paper proposes integration and a top 50% tax by shareholders. If elimination of the tax previously deferred is acceptable, how can it be worse to defer the tax than not to pay it at all?
- dividend stripping and the corporate surplus problem is another example cited. First, this is no longer a significant problem by reason of changes in legislation and recent court cases. Any remaining problem can be resolved by something far less than the global approach proposed. But more important, what is the real problem? It is that on death, the estate of the owner of a private company faces estate taxes which may require withdrawals of undistributed income which will be subject to income tax as well. This has unquestionably been a problem, but the proposals will make it worse in a great many cases, and will only help those private companies whose values do not exceed their book worth, but have substantial retained earnings. These will tend to be the least dynamic companies, as growth companies are normally valued substantially in excess of their book worth. Instead, the existence of a capital gains tax means that even if it is avoided by not realizing a capital gain on death, it still hangs over the head of the heirs as the corporate surplus used to do—but

then, there was at least the escape of a sale for a tax-free capital gain, which will no longer be possible. The proposal actually aggravates the essential problem it is claimed to alleviate—the potential double tax at death;

- neutrality of capital gains and dividends. This has some merit, but is only one aspect of the much larger and more important question of the appropriate taxation of capital itself. The importance of this neutrality is overrated in the White Paper, and not always followed either. Moreover, the same essential result can be achieved by a much simpler and more straightforward approach; for example, a 25% dividend tax credit and a top capital gains tax of 25%, with deemed realization of capital gains on death and elimination of the estate tax. This would also be a real solution to the double tax problem as well. Further, in important cases, this neutrality does not apply under the White Paper. This is so with widely-held corporations which have insufficient creditable tax because of fast write-offs due to capital intensity or high risk, incentives such as depletion to resource companies, or Canadian international companies with foreign dividend income. In these circumstances, the more favoured investor may well be the non-resident. The non-neutrality favours selling for a capital gain rather than receiving a dividend with inadequate creditable tax. And there is certainly no neutrality between closely-held, widely-held and foreign corporations; and
- alleged defects of the dividend tax credit. Two complaints were voiced against the dividend tax credit. The first complaint is that a corporation may have paid no tax yet shareholders still get the dividend tax credit. The answer is the dividend tax credit should be related to an appropriate incentive to invest in Canadian companies and not to what taxes they pay, which are the subject of other rules regarded appropriate by Parliament. What companies are appropriate for this incentive? Canadian international and resource companies? Are there any more profitable areas for Canadian risk investment? Yet these are the very companies which suffer in the switch from a

dividend tax credit to integration. The second complaint is that the credit benefits high income earners. Actually, this will be a very minor practical problem if the top rate is 50%, as the amounts could hardly be significant. A more refined credit related to tax rate levels could be developed but on a cost-benefit basis. We doubt the complexity is worth the minor gains in equity.

4.3 The proposed closely-held widely-held integration structure also rests on three important errors of fact:

- the view that closely-held companies compete primarily with other such companies and partnerships or proprietorships—and that widely-held companies compete primarily with other widely-held companies. An examination of the real world quickly discloses this is not true in so many important cases that it cannot be ignored. There is the related fact that in a number of cases, the closely-held companies that can elect the partnership option are in a more favourable competitive position than those who cannot do so. The absence of creditable tax is not a concern to them;
- the view that the type of company rather than the type of business determines the ability to pass on corporate tax to customers. How could it be so? In reality, the real question is whether taxes are regarded as a cost to be recovered, like other costs, in price. Except in very small businesses, we have no doubt the answer is yes for the vast majority of businessmen. This means the whole premise of integration and the distinction between corporations is built on sand, with results that are entirely predictable in advance; and
- partial integration for widely-held companies must remain a theory rather than a fact as far as investment decisions at the corporate level are concerned. It is impossible for management to assess tax consequences for its many shareholders. But what will be fact is the effect on share prices and the increased cost of equity capital for Canadian companies without credit-

able tax. As many of these will be growth companies, one may expect a trend away from Canadian ownership of these companies, and that new issues of the largest and strongest of such companies will be placed in the United States or elsewhere outside Canada. The trend toward repatriation of listed securities from non-resident to Canadian hands aided by the dividend tax credit and tax-free capital gains will in many cases be halted and reversed.

4.4 The proposed structure will have a number of important adverse productivity and growth effects:

- the cost of equity capital to Canadian companies with important international interests and to Canadian owned mineral resource companies will increase due to the effect of insufficient creditable tax under the integration proposal;
- the failure to recognize the financing requirements of small business by dropping the lower rate of tax without any off-setting provisions will retard the growth of new and small businesses;
- savings in Canadian hands will be reduced through the adverse effects already mentioned above and by the harsh capital gains proposals;
- the reduced taxation of distributed private company earnings and, to a lesser extent, of distributed public company earnings, will result in higher dividend pay-out and reduced reinvestment of earnings. This was one important reason why the United Kingdom abandoned integration. This reason would be even more pertinent for Canada because of the proposed common top rate of 50% and the proposed treatment of capital gains. These would strengthen the incentive to distribute rather than reinvest earnings;
- capital markets will be less efficient because the distinction between corporations and the proposed type of capital gains taxation will produce an emphasis on tax rather than business motivated investment decisions; and

- these corporation distinctions and the problems of creditable tax will induce the structuring of holdings of shares and assets in unusual ways to take maximum combined advantage of favourable features of creditable tax, lower capital gains rates or deferral of capital gains. All of these actions would be on the basis of tax rather than business considerations.

4.5 Integration by way of gross-up and credit is sadly deficient as a method of integration in the many cases where there is no creditable tax or where the tax credits are stale-dated. Moreover, if the corporate tax is a tax on the shareholders, logic would require that a corporate tax exemption is likewise a shareholder's tax exemption. Is there any ground for a "now you see it" tax rule at the corporate level, "now you don't see it" tax rule at the shareholder level? Is there not a fundamental inconsistency? It is a peculiar integration where only the taxed income and not the untaxed income is integrated to the shareholder level.

4.6 A strange inversion occurs where there are economic growth incentives at the corporate level. For example, of four possible categories of companies in the mineral industry each with insufficient creditable tax because of growth promoting write-offs at the corporate level only the non-resident shareholder and the closely-held partnership electing shareholder can retain the entire benefit of the corporate tax incentive at the shareholder level. The widely-held shareholder will lose only half of the benefit as the integration was only partial. The closely-held no partnership electing shareholder loses the whole benefit. The White Paper claims that the corporation tax is wholly or half a tax on shareholders because it is not shifted in whole or part to consumers. If this is so, the part of income subject to no tax or reduced tax at the corporate level should also be subject to no tax or reduced tax at the shareholder level where the corporate tax is supposed to be borne in whole or in part. But if this logic—which is the partnership election logic—is carried through, a major argument against the dividend tax credit collapses, and the essential argument for the proposed integration collapses as well.

4.7 It is apparent that the proposed structure is adverse to important national objectives. What is even more striking are the bizarre results which will become a matter of course if an attempt were ever made to introduce the system. Is it conceivable that a system of such complexity could last? How long could the economy survive investment decisions where the paramount question became taxation effects and not business merits? For the reasons discussed in this Chapter and in Chapter 2 it is clear that the system would collapse almost before it got started, leaving us even further back than where we started.

5 International Aspects

5.1 Most of the international implications of the White Paper proposals are retrograde from the point of view of the international competitiveness of Canadian business, the Canadian interest in fiscal harmonization and the risks of Canadian revenue losses through treaty negotiations.

5.2 There is explicit discrimination in not recognizing any credit to non-residents for the shareholder's tax portion of the corporate tax, while recognizing the credit for residents. The dividend tax credit does not run into this difficulty, because it is a credit for dividends received from Canadian companies entirely unrelated to actual Canadian corporation tax paid. This discrimination could create serious treaty negotiation problems and dangerous risks of substantial revenue losses to foreign treasuries. It is not helped by the fact that we could not afford reciprocity with the United States if they adopted a similar integration system.

5.3 The failure to recognize corporate taxes paid to foreign governments as taxes on shareholders on the same basis as taxes paid to Canada is likewise discriminatory against Canadian investment abroad. It is contrary to the Canadian interest in favourable access to relatively free non-discriminatory international capital markets. It is contrary to the Canadian interest in the development of Canadian multi-national corporations. It is contrary to the Canadian interest in the most efficient investment of its available funds. It is contrary to the Canadian interest in being a base or intermediary for international capital, enterprise and management looking not only to Canada but to every part of the world. There is no substitute for being "in the swim". These discriminations reduce Canada's chances in this respect. And again, this aspect is not helped by the knowledge of how much more difficult and expensive, if possible at all, it would have been for Canada to be developed to its current state if other countries, especially the United States, had similar provisions discriminatory against investment in Canada.

5.4 There are two features of the proposed “tax haven” provisions that deserve comment:

- the “passive income” provisions should not apply to any income derived outside Canada which is connected to active business operations outside Canada. It is no loss but rather gain to Canada if some foreign income of Canadians is able to be taxed at low rates. Indeed, there would be no reason in principle for not permitting a special exempt Canadian company to receive such lower taxed income—a possibility now being studied in the United States; and
- the Section 28 (1)(d) tax-free treatment of dividend income from 25% owned non-resident corporations should not be denied to the above type of low-taxed income—or to business income from non-treaty countries. There are two reasons for the above approach. The first is to keep Canadian international business competitive. The second is to avoid a moralistic “Canada knows best” approach to the tax laws of other countries and to leave it to other countries to decide what taxes they want to levy. We do not like it when the United States exports its laws to Canadian companies. Is there any reason to think other countries will like it any better when we do to them what we don’t want others to do to us? In effect, there are now to be “second class” countries. Is this the long-look future we are carving out for ourselves in the international arena? This is just another example of those who speak of standing up to Americans showing their profound subservience to ideas and practices from the United States, even where the Americans themselves have begun to have serious doubts. Surely, if a country feels a low income tax system in general, or a low tax on particular income, is appropriate, it is not for us to say we will nullify their law by picking up the tax slack unless it is Canadian source income that is escaping normal Canadian tax in the hands of Canadians.

5.5 There have no doubt been tax haven abuses. These can be cleaned up in four ways without recourse to the complex and competitively damaging “passive income” rules:

- where it is essentially Canadian source income that is being diverted out to the tax haven and back to Canada, there is good reason for specific direct action;
- where an unfair split of international income is made between a Canadian enterprise and a non-Canadian one, this can be dealt with under existing laws requiring fair pricing, or by appropriate expansion of these laws;
- where any material amount of “passive income” from foreign sources is not connected with business activity outside Canada, it too could be subject to special rules; and
- the elimination of surplus stripping should mean that realization of any so-called tax haven benefits will be subjected to Canadian tax when the money gets into the hands of the individual Canadian taxpayer for consumption.

5.6 There is a danger that an administratively tight or leak-proof tax system will prove economically airless as well. Not everything can be achieved by naked force, and some things have to rest on a general sense of fair play. The proposed departure tax treatment of personnel, including Canadian residents coming back and forth across the border, could produce the opposite to the desired effects—a “don’t fence me in” psychology. Canada would be better to lose some tax revenue by ignoring departure taxes and base its tax regime to a reasonable extent on the basis that Canada is a good place for capital. A departure tax will not strengthen the position of Canada as a good place for capital, and this reality should overrule the narrow revenue or avoidance principles behind the departure tax.

5.7 Canada has many dealings with the United States and other countries. Generally, we have dealt from a position of support for non-discrimination in tax and other laws as they affect the free movement of capital. We have a great stake in maintaining and expanding the free flow of capital in response to economic opportunity. An ineffectual but nonetheless clear discriminatory approach to international investment can have far reaching effects well beyond tax

treaty negotiations, which themselves could result in lost revenue. The question that must be asked is "for what?".

5.8 We do not agree with discrimination against portfolio investment by individuals, pension funds or others in foreign securities. This may be the only way Canada, through such investors, can participate in many new areas of profitable business. Special restrictions might be necessary for balance of payments reasons. But until these are required, we should strengthen rather than weaken our involvement in international activity. Canadians can now hold their own on the world stage on the basis of performance. It is time government stopped trying to prolong Canadian dependency on the protection of Mother Ottawa. We have grown up, but as often happens, Mother doesn't seem to realize it yet.

6 Mineral Industries

6.1 The verbal recognition in the White Paper of the high-risk capital intensity of mining and the special benefits of mining to Canada was reassuring and appropriate. Unfortunately two of the specific proposals—replacement of the new mine tax exempt period and the depletion allowance by a fast write-off and a weak exploration incentive in the guise of depletion—fail to translate the verbal recognition into effective policy.

6.2 No single group of proposals more clearly demonstrate the need to assess tax reform by how it affects major national objectives on the basis of evidence rather than theory than do these two proposed changes in mining taxation. The immediate effect of these changes will be sharp reductions in earnings and cash flows and in the value of existing properties and new discoveries. It is hard to square this with the statement in the White Paper that only a moderate reduction in mining activity is anticipated. No evidence is adduced to support this statement and it would be contrary to all experience if major changes did not produce major results.

6.3 There are two questions to be asked:

- are we concerned if mining activity ceases to grow as it could?
- are there good reasons for believing the new proposals will serve as well as the present incentive system?

6.4 In a broad national context, the existing provisions have stimulated the high productivity and growth essential to improving the lot of people. They have also promoted better balance as between regions, which in turn has strengthened the economic and political framework of the nation.

6.5 The mining record in the last quarter-century is perhaps the most impressive of any major sector of the Canadian economy. Here are just five key facts about our mineral industries:

- annual rate of growth is double that for the whole economy;

- it is by far the largest contributor to Canada's balance of payments;
- it is the only major goods-producing sector in the economy 100% or better as productive as U.S. industry—the Canadian average is about 70%;
- it has one of the highest average wages, in every region, of any major sector of the Canadian economy; and
- it is largely based outside the centrally located industrial regions of Canada.

6.6 Here are four key factors about Canadian mining in the seventies:

- metal ore reserves are now more difficult and more expensive to find in Canada than in countries like Australia, and are usually lower grade as well;
- Canadian developments are usually in remote areas and have a very high capital cost;
- radical reductions in ocean transportation costs are not matched by reductions in Canadian railway or lakeshipping costs, thus shifting the international competitive balance from Canada; and
- the regions dependent on Canadian mineral industries cannot, because of their lack of a broad industrial base, afford to have mining activity decline.

6.7 Everything points to tougher than ever competition for Canadian minerals. Canada needs every successful economic and regional development policy it can set. Everything about the record points to the conclusion that the mining incentives are just that. It is hard to think of another policy which has so effectively combined high economic efficiency with regional development.

6.8 The present incentives are value-related. They make discoveries more valuable by increasing after-tax earnings and cash flows. The record demonstrates that they have worked well. The onus is on those who think they can improve upon this remarkable record.

6.9 The White Paper suggests its cost-related incentives can achieve the same result more cheaply. The question is whether this is likely to be true. There is only one way to find out for sure, and that is to try and then accept the consequences. If the consequences are unfavourable, however, it will be too late to restore the situation, as interest shifts away from Canada and big developments go forward in other parts of the world.

6.10 Persistence in time and money is, to a far greater degree than usual, the prerequisite to ultimate mining success. In mining the investment per dollar of sales is astronomical in comparison with most other industries. These are two good reasons to believe that the rare character of mineral discovery coupled with the rapidly escalating costs of discovery is such that the size of the "win" (which would be substantially reduced by the White Paper) is of vital importance to the mining investment climate.

6.11 This climate of a "big win" for success is far more powerful in encouraging exploration in Canada than the proposed weak exploration incentive. This is crucial, because without exploration there can be no new discoveries, and without discoveries, no new mines.

6.12 These facts argue for continuance of the basic features of the present value-related incentives in principle. But more than this, the dollar value of the incentives must also be maintained. If the estimates of the Province of Ontario are close, an annual drop of nearly 200 million dollars in the earnings of mineral companies through additional taxes will have a crushing effect, reducing both cash for exploration and investment, and the ability to raise external debt and equity funds as well. The value of the present incentive provisions is estimated to drop under the White Paper by up to 75% for mining generally and by 85% for iron ore mining to feed the Canadian steel industry.

6.13 It is not only a question of performance, it is also a question of fairness. The provinces impose a heavy mining tax which, combined with the White Paper changes, could make mining more heavily taxed than other industry. The corporation tax is not always fair but the present mining provisions make it more rather than less fair.

6.14 A principle of the White Paper is that taxes not paid by one taxpayer must be made up by the remaining taxpayers. We do not agree that this should necessarily be the case, particularly where the result of tax reduction is to promote high productivity industry which expands the tax base. But if it is a principle it has equal application to the tariff, the annual cost of which is now estimated at some eight billion dollars. It is difficult to justify the White Paper assertion of overly generous treatment of the mineral industries in the face of the annual cost of the tariff.

6.15 In summary, the effectiveness of the existing provisions in achieving a top economic record for Canada, and fairness in balancing of government policies between industries and regions, dictate continuance of the provisions in their present form and amount.

7 Conclusion

7.1 We have discerned six main elements of the White Paper approach to tax reform, and have attempted to assess the proposals from each of these points of view. Our conclusion is that the White Paper scores well on its social objectives, as far as they go, less than a pass on the equity aspects and fails badly on four counts—its structural proposals, its contribution to national objectives, the sheer quantity of the proposed changes and the revenue implications.

7.2 In arriving at this conclusion, we have necessarily levelled a number of serious and damaging charges at several important features of the White Paper approach. If these charges have been sustained by the reasoning advanced, the Proposals will require major, not merely cosmetic surgery. At the same time, the tax reform patient need not die.

7.3 We are concerned by the apparent lack of understanding of the role of private capital in Canadian hands for the advancement of Canada and the well-being of its people. In this connection, the most damaging feature of the White Paper approach is its equation of so-called capital gains with income. If this misconception persists, it will be extremely difficult to avoid tax reform which will result in lasting damage to Canada's economy and society. We have sought to demonstrate the fallacy of this equation, and to set out the tough criteria which will have to be met if any proposal to tax capital gains is not to be self-defeating in terms of real benefit to people, by retarding growth and Canadian ownership.

7.4 We are satisfied that the problems of corporations and their shareholders under the present Act do not require a radical new tax structure. Our conclusion would not change if a capital gains tax were introduced, as we feel any such tax must be separated from the income tax as being a different type of tax—namely, a tax on capital, more like gift or estate taxation, although computed by reference to only a portion of total capital.

7.5 Canada in the seventies faces two separate but closely linked economic challenges. The first is to continue and accelerate the development of every part of Canada, with as much of this development as possible in Canadian hands. This effort will continue to require significant imports from outside Canada of capital, enterprise, technology and people skills. The second is to get more deeply involved than ever in world economic development, by exporting our own capital, enterprise, technology and people skills and equally important by making Canada an attractive base from which the capital, enterprise, technology and people skills of non-residents can be deployed for both North American and world business and financial activity. The White Paper approach of international tax discrimination and unilateral deviance from accepted norms of international tax harmonization is retrograde, and will severely limit Canada's ability not only to develop Canada but also to achieve the effective and profitable role it could otherwise play in fast changing world economic developments.

7.6 Canadian ownership will not be advanced by any of the provisions of the White Paper. It will be retarded by many—especially by the adverse savings effects of the capital gains tax and the elimination of recognition of small business financing problems, and by the negative proposals for mining and Canadian based international investment.

7.7 Tax reform of the size and divisive dimensions of the White Paper in its present form would require a continuing over-commitment of resources to a policy area that at the very best cannot mean enough real benefits to people to warrant the risks and efforts involved. The result of over-ambition could very easily become severe breakdown with serious loss rather than gain. It would be a Pyrrhic victory indeed if the tax technocrats got the tax structure they want while we lost the Canada we want.

7.8 The task of maintaining Canada now clearly depends in large measure on attracting capital and enterprise to every part of Canada

on a basis where it will be productive enough to provide good jobs and incomes. It would be a mistake to think we can get big increases of capital investment in the places where it is needed most, if the general climate for capital in Canada worsens. Ironically, it is capital for the high productivity mineral industries with their broad regional spread, where the White Paper impact will be sharpest.

7.9 Canada has always been an incentive society. Hard work and successful effort have always been rewarded. The tax system, taken as a whole, has not borne too heavily on initiative. And all this has been accompanied by substantial improvements in the well-being of almost all Canadians. The success of some has worked to the benefit of all. That there is more to do is unquestioned. That the accomplishment of this now depends on governments to a greater degree than on individuals is seriously questioned. For the day the goals of the state take precedence over the goals of individuals and their ability to achieve them is the day we will have a very different Canada from anything any of us have ever known.

7.10 Many aspects of modern life sap initiative. Sheer size and complexity give many people the feeling that they cannot shape their own destiny. Public policy should strengthen initiative by strengthening the incentives which help people feel they can make something of their own lives through creative effort. It will take more than the tax system to achieve this—but it is essential that the tax system not weaken incentives. Getting ahead on the basis of good performance is still a worthy goal. Without this goal where would mankind be?

7.11 The thrust of the White Paper does nothing to strengthen the economy or the individual in our society. Our prime tax reform objectives should be to strengthen the economic environment and to strengthen the incentives for people to respond fully to the many challenges of Canada in the seventies.

7.12 Our conclusions for tax reform action are these:

- the desirable social objectives (downgrading the role of Canadian private capital is not one) can be readily and quickly achieved without radical change in the essential framework of the present system.
- the equity aims of reform can only be achieved by
 - eliminating the proposed approach to the taxation of corporations
 - providing for the recognition of inflation in taxation
 - eliminating the proposed discrimination in international investment.
- the closely-held widely-held integration, common top corporate-personal rates, and capital gains as income proposals constitute a structural package which is inherently unstable. It lacks the necessary durability, understandability and flexibility to be implemented and would stimulate a major increase in tax-motivated decisions. The structural package should be abandoned.
- the dividend tax credit, or an equivalent, should be retained which would avoid the treaty risks of substantial revenue losses, together with tax-free inter-corporate dividends.
- the weight of Canada's economic requirements makes a capital gains tax undesirable on balance. But if there is to be one, a completely new plan to that proposed is required, based on the fact that capital as a source of future income is not the same as current income.
- the proposals must be revised to retain and preferably to improve the volume of private savings in Canadian hands. Canada needs a national savings policy for the seventies. Canada also needs to broaden its economic democracy. Tax reform should help rather than hinder by including:
 - an adequate tax concession to finance new and growing smaller business
 - continuance of the present incentives to the highly productive and regional development oriented mineral industries
 - a very different capital gains—estate tax mix
 - a savings incentive geared to the low and middle income earners.

- the restrictive and discriminatory international proposals must be abandoned so that Canada can advance as a base for international business and financial activity.
- there must be a clear rejection of the thrust of the White Paper to preempt an ever increasing share of the national income for the federal government.

7.13 These conclusions are based on the realities of Canada and the ambitions of its people. They will strengthen the economic environment and provide incentive for Canadians to build for themselves and the future of Canada.

